

***United States Court of Appeals
for the Second Circuit***



APPENDIX

ORIGINAL **74-1293**

United States Court of Appeals

For the Second Circuit.

HARRY LEWIS,

Plaintiff-Appellant,

against

GEORGE L. VARNES,

Defendant-Appellee,

and

ELI LILLY AND COMPANY,

Defendant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK.

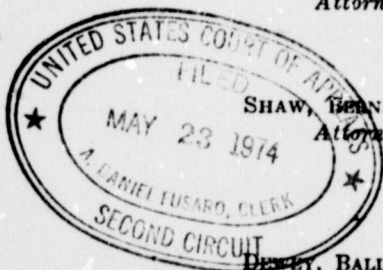
APPENDIX.

MORRIS J. LEVY,

Attorney for Plaintiff-Appellant,

261 Broadway,

New York, N. Y. 10007



SHAW, BENSTEIN, SCHEUER, BOYDEN & SARNOFF,

Attorneys for Defendant-Appellee,

George L. Varnes,

292 Madison Avenue,

New York, N. Y. 10017

DEWEY, BALLANTINE, BUSHBY, PALMER & WOOD,

Attorneys for Defendant,

Eli Lilly and Company,

140 Broadway,

New York, N. Y. 10005

PAGINATION AS IN ORIGINAL COPY

Index to Appendix.

	Page
Relevant Docket Entries	1a
Complaint	3a
Plaintiff's Notice of Motion	7a
Notice of Motion by Defendant George L. Varnes	8a
Stipulation and Statement Pursuant to Rule 9(g) of the General Rules of the District Court	9a
Opinion	18a
Judgment Appealed From	23a

United States Court of Appeals

FOR THE SECOND CIRCUIT.

HARRY LEWIS,

Plaintiff-Appellant,

against

GEORGE L. VARNES,

Defendant-Appellee,

and

ELI LILLY AND COMPANY,

Defendant.

Relevant Docket Entries.

1972

- Nov. 16 Filed complaint & issued summons.
- Dec. 11 Filed Answer by deft. to complaint.
- Dec. 20 Filed summons with Marshals return: Served:
Eli Lilly & Co. on 11-21-72 George L. Varnes
on 11-29-72.
- Dec. 19 Filed Pltff's interrogs addressed to deft. G.
L. Varnes.

1974

- Jan. 4 Filed pltff's notice of motion *re*: summary
judgment ret: no date.
- Jan. 4 Filed Memo-End. on motion dtd this date . . .
Pltff's motion denied. See opinion filed here-
with. Pollack, J. mn
- Jan. 4 Filed deft Geo. Varness's notice of motion
re: dismissal ret: 2-2-74.

Relevant Docket Entries

- Jan. 4 Filed deft Geo. Varnes' notice of motion *re*: summary judgment, etc.
- Jan. 4 Filed Memo-End. on motion dtd this date, motion granted in accordance with opinion filed herewith. Pollack, J. mn
- Jan. 4 Filed Opinion #40171 . . . Summary judgment dismissing the Sec. 16(b) claim is granted to deft. The Se. 10(b) claim is dismissed for failure to comply with Fed. R. Civ. P. 9(b), with leave to replead within 20 days upon a proper factual showing or, if upon information and belief, upon a full and sufficient assertion of the basis thereof. Complaint dismissed accordingly, with costs. Pollack, J.
- Jan. 7 Filed Judgment—Ordered that defts Geo. Varnes, and Eli Lilly and Co. have summary judgment against the plttf Harry Lewis dismissing the complaint with costs to be taxed. Pollack, J.
- Jan. 31 Filed plttf's notice of appeal from final judgment ent. 1-7-74. Mailed copies to Shaw, Bernstein, Scheuer, Boyden & Sarnoff, Dewey, Ballantine, Bushby, Palmer & Wood.

Complaint.

UNITED STATES DISTRICT COURT,
SOUTHERN DISTRICT OF NEW YORK.

HARRY LEWIS,

Plaintiff,

against

GEORGE L. VARNES and ELI LILLY AND COMPANY,

Defendants.

Plaintiff, by Morris J. Levy, his attorney, complaining of the defendants, alleges as follows:

AS AND FOR A FIRST CAUSE OF ACTION.

1. Plaintiff is the owner of common shares of stock of the defendant, Eli Lilly and Company, (hereinafter referred to as the "Issuer"), and brings this action on behalf and in the right of the Issuer.

2. Jurisdiction of this action is conferred upon this Court and arises under the provisions of Section 16(b) and 27 of the Securities Exchange Act of 1934, 15 U.S.C., Sects. 78p(b) and 78aa, and other relevant sections. This action is not a collusive one to confer jurisdiction of a cause upon a court of the United States of which it would not otherwise have cognizance.

3. Upon information and belief that the amount in controversy, exclusive of interest and costs, exceeds the sum of \$10,000.00.

4. Upon information and belief that at all times hereinafter mentioned the Issuer was and still is a corporation

Complaint

duly organized and existing by virtue of the laws of the State of Indiana.

5. Upon information and belief that at all times herein-after mentioned the Issuer's shares of common stock were duly registered with and listed upon the New York Stock Exchange, a national securities Exchange, and were not exempted securities.

6. Upon information and belief that on January 31, 1971, and for a certain continuous period of time prior to that date, the defendant, George L. Varnes, was a director and officer of the Issuer; the said defendant resigned his positions as an officer and director of the Issuer effective at the close of business on January 31, 1971.

7. Upon information and belief that by reason of his official positions as a director and officer of the Issuer, the defendant, George L. Varnes, was privy to inside information concerning the affairs of the Issuer which was not available to the investing public.

8. Upon information and belief that on the date he resigned as a director and officer of the Issuer the defendant, George L. Varnes, was the owner of unexercised options previously granted to him by the Issuer for his acquisition of 23,000 common shares of the Issuer's stock.

9. Upon information and belief that between on or about February 2, 1971 and July 6, 1971, a period of less than six months following his resignation as an officer and director of the Issuer, the defendant, George L. Varnes, exercised his options and acquired 23,000 shares of the Issuer's common stock, and also sold 6,300 shares of the Issuer's common stock.

10. Upon information and belief that the transactions effected in the Issuer's securities by defendant, George

Complaint

L. Varnes, as set forth in paragraph "9" herein, were in violation of the provisions of Section 16(b) of the Securities Exchange Act of 1934 and subjected the said defendant to its provisions within the intent and purpose of that statute.

11. Upon information and belief that as a result of the transactions set forth in paragraph "9" herein, the defendant, George L. Varnes, realized profits therefrom which inured to but have not been recovered by the Issuer.

12. Upon information and belief that certain of the transactions referred to in paragraph "9" herein were effected by the defendant, George L. Varnes, within the territorial limits of the Southern District of New York.

13. Upon information and belief that the equity securities referred to in paragraph "9" herein were not acquired by defendant, George L. Varnes, in connection with any debt previously contracted by him.

14. That on September 14, 1972, plaintiff's attorney, acting on behalf of the plaintiff herein, sent a written communication to the Issuer advising it of the facts and requesting that it institute appropriate action against defendant, George L. Varnes, to recover the profits realized by him from his transactions in the Issuer's securities as hereinabove alleged. Although more than sixty (60) days have elapsed since such request was made, the Issuer has failed and refused to institute such action.

AS AND FOR A SECOND CAUSE OF ACTION.

15. Jurisdiction of this claim is conferred upon this Court and arises under the provisions of Sections 27 and 10(b) of the Securities Exchange Act of 1934, 15 U.S.C., Sects. 78aa and 78j(b), and the Commission's Rule 10b-5 promulgated thereunder. This action is not a collusive one to confer jurisdiction of a cause upon a

Complaint

Court of the United States of which it would not otherwise have cognizance.

16. Plaintiff repeats and reiterates each and every allegation set forth in paragraphs of this complaint numbered "1", and "3" through "14", inclusive, with the same force and effect as though said allegations were fully set forth herein.

17. Upon information and belief that during the times he effected his transactions in the Issuer's securities, as set forth in paragraph numbered "9" herein, the defendant, George L. Varnes, possessed inside information with respect to the affairs of the Issuer which was not generally available to the investing public or to the other stockholders of the Issuer, and said defendant unfairly used such inside information in effecting such transactions and profiting therefrom.

WHEREFORE, plaintiff demands judgment against the defendants, as follows:

(a) That the defendant, George L. Varnes, be directed to account and pay over to the Issuer all profits realized by him from his transactions in the Issuer's stock, as alleged herein, and that judgment be entered against defendant, George L. Varnes, for all such recoverable profits, together with interest.

(b) That plaintiff be awarded his costs and disbursements of this action, including a reasonable counsel fee to his attorney.

(c) That plaintiff have such other, further and different relief as the Court may deem proper.

MORRIS J. LEVY
Attorney for plaintiff

(Verified.)

Plaintiff's Notice of Motion.

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

SIRS:

Please Take Notice that upon the annexed Stipulation of Facts and Statement under Rule 9(g) of the General Rules of this Court, dated September 24, 1973, and upon all the pleadings and proceedings heretofore had herein, the plaintiff, Harry Lewis, will move this Court at the United States Courthouse, Foley Square, New York, N.Y., at a date and time to be determined by the Court, for an order, pursuant to Rule 56 F.R.C.P., granting a summary judgment in favor of the plaintiff and against the defendants for the relief demanded in the complaint, on the ground that there are no genuine issues as to any material fact and that plaintiff is entitled to a judgment as a matter of law, and granting plaintiff such other and further relief as the Court may deem just.

Dated: New York, New York;
October 5, 1973.

Yours, etc.

MORRIS J. LEVY
Attorney for plaintiff

To:

Shaw, Bernstein, Scheuer, Boyden & Sarnoff, Esqs.
Attorneys for defendant, George L. Varnes

Dewey, Ballentine, Bushby, Palmer & Wood, Esqs.
Attorneys for defendant, Eli Lilly and Company

Notice of Motion by Defendant George L. Varnes.

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

SIRS:

Please Take Notice that upon the annexed Stipulation and Statement pursuant to Rule 9(g) of the General Rules of this Court, dated September 24, 1973, and upon the pleadings and proceedings heretofore had herein, the undersigned will move this Court at the United States Courthouse, Foley Square, New York, New York, at a date and time to be determined by the Court,

(a) for an order, pursuant to Rule 56 of the Federal Rules of Civil Procedure, for summary judgment dismissing the complaint as to defendant George L. Varnes, together with the costs and disbursements of this action, on the ground that there is no genuine issue as to any material fact and that said defendant is entitled to judgment as a matter of law; and

(b) for such other and further relief as to the Court may seem just and proper.

Dated: New York, New York
September 24, 1973

**SHAW BERNSTEIN SCHEUER
BOYDEN & SARNOFF**

By (Illegible)
A Member of the Firm
Attorneys for Defendant George L. Varnes

To:

Morris J. Levy, Esq.
Attorney for Plaintiff

Dewey, Ballantine, Bushby, Palmer & Wood, Esqs.
Attorneys for Defendant, Eli Lilly and Company

**Stipulation and Statement Pursuant to Rule 9(g) of
the General Rules of the District Court.**

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

IT IS HEREBY STIPULATED AND AGREED by and among the attorney for plaintiff and the attorneys for defendants that if defendant George L. Varnes were called as a witness at a trial of this action he would give the testimony which is set forth in paragraphs 1 through 23 of this stipulation; and it is

FURTHER STIPULATED AND AGREED that paragraphs 1 through 23 of this stipulation and the exhibits A through U annexed hereto shall be deemed an affidavit and exhibits of defendant George L. Varnes for purposes of any motion or cross-motion under Rule 56 of the Federal Rules of Civil Procedure.

1. I reside at 8110 Bramwood Court, Indianapolis, Indiana. I also have a home in Scottsdale, Arizona.

2. I first began employment with Eli Lilly and Company ("Lilly") in 1940 as a salesman. In 1947 I was promoted to Production Manager, in 1952 to Director of Production and in 1953 to General Manager. In 1954 I became president of Elanco Products Company, a division of Lilly, and in 1966 I became Group Vice President of Domestic Subsidiaries of Lilly, which position I held until my retirement at the end of January 1971. In 1964 I was elected a director of Lilly and remained so until my retirement.

3. From January 1, 1970 to December 21, 1970, I was a member of various committees of Lilly, including its executive committee. After that date I was not a member of any Lilly committees.

*Stipulation and Statement Pursuant to Rule 9(g) of the
General Rules of the District Court*

4. For a number of years prior to my retirement I was eligible to receive grants of options under Lilly's stock option plans. During the period 1967-1970, there were between 159 and 282 employees who were granted stock options each year under these plans. On January 20, 1967, I was granted an option to purchase 4,000 shares of Lilly stock at a price of \$89.50 a share. On January 19, 1968, I was granted an option to purchase 4,000 shares of Lilly stock at a price of \$103.50 a share. On February 7, 1969, I was granted an option to purchase 4,000 shares of Lilly stock at a price of \$79.08 a share and on May 18, 1970, I was granted an option to purchase 3,000 shares of Lilly stock at a price of \$87.50 a share. Copies of each of those stock option grants, together with letters of transmittal from the President of Lilly, are annexed hereto as Exhibits A, B, C and D.

5. On November 26, 1968, the shareholders of Lilly voted a two-for-one stock split. As a consequence of that split and pursuant to the terms of the stock options granted me on January 20, 1967 and January 19, 1968, I was thereafter entitled to purchase 8,000 shares under the 1967 option at a price of \$44.75 a share and 8,000 shares under the 1968 option at a price of \$51.75 a share. Copies of letters dated December 6, 1968 from C. Harvey Bradley, Jr., general counsel of Lilly, explaining the effect of the stock split upon my option rights are annexed hereto as Exhibits E and F.

6. By reason of my stock option grants listed above, as adjusted to reflect the stock split, on December 22, 1970 I had the right to purchase 23,000 shares of Lilly stock. In addition, on that date, I was the owner of 12,000 shares of Lilly stock unrelated to those stock options.

*Stipulation and Statement Pursuant to Rule 9(g) of the
General Rules of the District Court*

7. While I was employed by Lilly, it was the practice of Lilly to keep its directors and officers informed of their obligations under the Federal Securities Laws. From time to time, executive employees were advised by Mr. Bradley, Lilly's general counsel, of their rights and duties under such statutes. In 1968, in connection with such briefing, I asked Mr. Bradley whether the provisions of §16(b) of the Act applied to an ex-director or officer after his retirement. Although at that time I had no intention of retiring, I was interested in knowing a director's or officer's post-employment obligations, as well as those obligations he had prior to retirement.

8. Under date of May 16, 1968, I received a memorandum, a copy of which is annexed hereto as Exhibit G, from Mr. Bradley in response to my question.

9. Under date of April 1, 1969, I received from Mr. Bradley a copy of a memorandum sent to Mr. J. O. Waymire, Lilly's then Vice President of Finance, clarifying the May 16, 1968 memorandum to me with respect to the applicability of §16(b) of the Act to a purchase or sale of Lilly stock by a director or officer after retirement. A copy of the memorandum is annexed hereto as Exhibit H.

10. Under date of March 9, 1970, I received a further memorandum from Mr. Bradley directed to the officers and directors of Lilly, to which was attached a memorandum of Fred B. Croner, Jr., a Lilly attorney, together with a copy of amended regulation §240.16a-1 of the SEC. Copies of these documents are annexed hereto as Exhibit I.

11. Partly due to reasons of health, I decided to retire at the end of the year 1970 or the beginning of 1971. In early December 1970, I notified Lilly and resigned from

*Stipulation and Statement Pursuant to Rule 9(g) of the
General Rules of the District Court*

a number of committees on which I had served. Although my resignation as a director and officer of Lilly was not to take effect until January 31, 1971, my last day at work was December 24, 1970. On that day, my wife and I went to our home in Scottsdale, Arizona. I returned to Indianapolis in mid-January for a brief period to participate in a farewell party given me by Lilly on January 18, 1971. Other than to submit my resignation from my remaining positions with Lilly and to attend a final directors' meeting on the day of the party, I had no business dealings with Lilly or its employees from December 24, 1970 to my retirement.

12. Since January 31, 1971, I have had no employment or consultant contracts with Lilly of any nature. Since that date I have taken no part in the business of Lilly, nor have I been consulted by Lilly concerning its business.

13. Under the terms of my stock option grants, the options expired two months after my retirement. Consequently, in December 1970, shortly before my retirement, I gave consideration to my option rights. Since the prices under my options ranged from \$44.75 to \$87.50 a share, whereas the market price of Lilly stock during the last half of 1970 ranged from a high of 104-3/4 to a low of 77-7/8 per share, there was no question but that I would exercise some, if not all, of my options. I was aware, however, that in order to exercise all my options, it would be necessary for me to borrow a substantial sum of money in order to pay for the shares. Since I did not want to maintain a large debt on which I would be required to pay interest, I contemplated that if I exercised all my options, I would sell enough shares of my Lilly stock to discharge any such debt as soon as I was no longer restricted by §16(b) of the Act.

*Stipulation and Statement Pursuant to Rule 9(g) of the
General Rules of the District Court*

14. Prior to my retirement, on December 22, 1970, I purchased 1,600 shares of Lilly stock pursuant to the 1967 option grant, at a price of \$44.75 a share. This was the last purchase of Lilly stock I made while an officer or director or employee of Lilly. I made no sale of Lilly stock from that date until July 6, 1971.

15. On February 2, 1971, following my retirement, I purchased 6,400 shares of Lilly stock at a price of \$44.75 a share, consisting of the balance of the shares available to me under my 1967 option, and on the same day I purchased the full 8,000 shares available to me under my 1968 option, at a price of \$51.75 a share. On February 2, 1971, the market price of Lilly stock was approximately \$110.00. On March 26, 1971, I exercised my 1969 option by purchasing 4,000 shares from Lilly at a price of \$79.08 a share, and my 1970 option by purchasing 3,000 shares from Lilly at a price of \$87.50 a share. On that date the market price of Lilly stock was approximately \$118.00. Upon the exercise of the last of my options, I owned a total of 35,000 shares of Lilly stock. Annexed hereto as Exhibits J, K, L and M are copies of written declarations to exercise my stock options.

16. In order to finance the purchase of the option shares, I borrowed from the American Fletcher National Bank and Trust Company approximately \$653,000.00. At the time of the borrowings I advised the Bank that it was my intention to sell sufficient of my Lilly shares to repay my debt as soon as I was permitted to do so without violating the provisions of §16(b) of the Act.

17. As a precaution, before selling any of my Lilly shares, I also consulted my personal attorney, Elmer E. Lyon, Esq., concerning the earliest date I would be able to sell my Lilly stock free of the restrictions of §16(b)

*Stipulation and Statement Pursuant to Rule 9(g) of the
General Rules of the District Court*

of the Act. In order to foreclose any possibility that I might inadvertently violate §16(b) in connection with the contemplated sale, I sought advice from the SEC on June 3, 1971. On that date I sent a letter, a copy of which is annexed hereto as Exhibit N, to the General Counsel of the SEC.

18. Under date of June 28, 1971, I received a reply to my letter from Mr. Robert E. Taylor, Chief, Section of Ownership Reports, a copy of which is annexed hereto as Exhibit O.

19. Subsequent to the receipt of Mr. Taylor's reply, I was advised by Mr. Lyon that he had spoken with Mr. Bradley, Lilly's general counsel, and that both were of the view that any impediment to the sale of my stock under §16(b) of the Act expired on June 22, 1971 and that I was free to sell my Lilly stock thereafter without any liability to Lilly.

20. On July 6, 1971, I instructed my broker, Rafensperger, Hughes & Co. of Indianapolis, Indiana, to sell 6,300 of my Lilly shares. Of those shares, 5,400 were sold at 124-1/2 which, after payment of commissions, fees and taxes, netted \$669,492.55. Four hundred shares were sold at 124-3/4 and 500 shares at 125-1/4 which, after payment of commissions, fees and taxes, netted \$112,138.74. The net proceeds on all these sales were \$781,631.29. The proceeds of sale were used to discharge my debt to the bank and for payment of income taxes resulting from the sale. Copies of my broker's confirmation are annexed hereto as Exhibits P, Q, R, S and T.

21. On July 13, 1971, as required by the Lilly Stock Option Plans, I notified Mr. Bradley by letter, a copy of which is annexed hereto as Exhibit U, of the sale that had taken place on July 6, 1971.

*Stipulation and Statement Pursuant to Rule 9(g) of the
General Rules of the District Court*

22. Following the sale on July 6, 1971, I continued to hold 28,700 shares of Lilly stock. I sold no other Lilly shares in 1971. Under the tax laws applicable to qualified stock options, the sale of my 6,300 shares before I had held them for three years resulted in taxable income to me in the year 1971 of \$220,109.76 on which I paid ordinary income taxes. Lilly, on the other hand, had the tax benefit of a deduction from its income of the \$220,109.76, even though I received no money from Lilly in this regard. Because of my aversion to having outstanding a large personal debt, I preferred selling a few of my shares, notwithstanding the onerous tax consequences, to continuing the debt.

23. Based on the memoranda and advice outlined above, I was of the opinion that §16(a) and (b) of the Act and the pertinent SEC regulations permitted me to sell my Lilly stock after June 22, 1971 without any liability. My sales of July 6, 1971 resulted from that belief. I believe that I did everything possible to assure that I would do nothing to violate my obligations under the Act or to subject me to any criticism whatsoever. Although I believe that my sales on July 6, 1971 were not subject to the disclosure requirements of §16(a) of the Act, I notified Lilly of my intention to sell and sought its advice, as well as that of my counsel; I also notified and sought the opinion of the SEC; and I even filed a form 4. I took all these steps out of an absolute conviction that my sales were lawful and a desire to avoid any conceivable innuendo concerning them.

IT IS FURTHER STIPULATED AND AGREED that for the purposes of any motion or cross-motion by any party under Rule 56 of the Federal Rules of Civil Procedure the following statements are true:

*Stipulation and Statement Pursuant to Rule 9(g) of the
General Rules of the District Court*

24. At all relevant times mentioned in the complaint, plaintiff was the record and beneficial owner of common shares of Lilly.

25. This action was not collusively brought to confer jurisdiction upon a Court of the United States.

26. The amount in controversy, exclusive of interest and costs, exceeds the sum of \$10,000.

27. Lilly is a corporation duly organized and existing under the laws of the State of Indiana.

28. At all relevant times mentioned in the complaint, the shares of Lilly were registered with and listed upon the New York Stock Exchange, a national securities exchange, and were not exempted securities.

29. Under date of September 14, 1972 plaintiff's attorney, acting on behalf of plaintiff, sent a letter to Lilly, a copy of which is annexed hereto as Exhibit V. By letter dated September 22, 1972, a copy of which is annexed hereto as Exhibit W, Mr. Bradley, on behalf of Lilly, replied to plaintiff's attorney.

30. During the period January 6, 1971 through January 6, 1972, the lowest price of Lilly stock sold through the New York Stock Exchange was \$100.00. On September 28, 1971 the stockholders of Lilly approved a two-for-one stock split. The stock prices set forth in this stipulation are based on the number of outstanding shares before the 1971 stock split.

*Stipulation and Statement Pursuant to Rule 9(g) of the
General Rules of the District Court*

31. Plaintiff did not sell to or purchase from defendant Varnes any shares of Lilly stock.

Dated: New York, New York
September 24, 1973

MORRIS J. LEVY
Attorney for Plaintiff

SHAW BERNSTEIN SCHEUER BOYDEN
& SARNOFF

By MERTON SARNOFF
A Member of the Firm
Attorneys for Defendant Varnes

DEWEY, BALLANTINE, BUSHBY,
PALMER & WOOD

By L. ROBERT FULLEM
A Member of the Firm
Attorneys for Defendant Eli Lilly
and Company

(Annexed Exhibits Appear in a Separate Exhibit
Volume.)

Opinion.

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

Appearances:

Morris J. Levy, Esq., Attorney for Plaintiff, 261 Broadway, New York, N. Y. 10007.

Shaw, Bernstein, Scheuer, Boyden & Sarnoff, Attorneys for Defendant (Varnes), 292 Madison Avenue, New York, N. Y. 10017 By: Merton Sarnoff, Esq., of Counsel.

Dewey, Ballantine, Bushby, Palmer & Wood, Attorneys for Defendant (Lilly), 140 Broadway, New York, N. Y. 10005.

Milton Pollack, District Judge.

POLLACK, District Judge:

This is an action in which plaintiff, a stockholder of Eli Lilly and Company ("Lilly"), registered with and listed on the New York Stock Exchange, seeks to recover on its behalf against defendant George L. Varnes for alleged violations of Section 16(b) of the Securities Exchange Act of 1934 and Section 10 and Rule 10b-5 thereunder, 15 U.S.C. §§78p(b), 78j, popularly referred to as "short swing" transactions.

The Section 16(b) Claim

The §16(b) claim is to recover alleged profits made by Varnes as a result of his purchases and sales of Lilly stock within a period of less than six months. The plaintiff alleges that he made demand upon Lilly to sue Varnes but that it failed to do so.

The undisputed facts are that Varnes was a Vice President and Director of Lilly from 1966 through January 31, 1971. During the course of his employment with Lilly, Varnes was granted the following relevant stock

Opinion

options: January 20, 1967, 4,000 shares at \$89.50 per share; January 19, 1968, 4,000 shares at \$103.50 per share; February 17, 1969, 4,000 shares at \$79.08 per share; May 18, 1970, 3,000 shares at \$87.50 per share. By reason of stock splits, the first two options were increased to 8,000 shares at \$44.75 per share and 8,000 shares at \$51.75 per share, respectively, prior to Varnes' retirement.

On December 22, 1970, while still an officer and director of Lilly, Varnes exercised part of the 1967 option to purchase 1,600 shares. With the exception of this transaction, on January 31, 1971—the date his resignation and retirement became effective—Varnes had not exercised his various options for Lilly shares. These options by their terms would expire two months after his resignation and retirement became effective, or on March 31, 1971.

On February 2, 1971—two days after his resignation and retirement as an officer and director of Lilly became effective—Varnes purchased 6,400 Lilly shares by exercising the balance of the 1967 option. On the same date, he also purchased 8,000 shares by exercising the 1968 option. On March 26, 1971 he purchased 7,000 shares of Lilly stock by exercising the remaining 1969 and 1970 options. However, plaintiff believes that these latter two purchases are not material herein "because defendant's purchases can only be matched against the 6,300 shares which he sold on July 6, 1971."

On July 6, 1971—more than six months after his last purchase while still an officer and director of Lilly, but less than six months after both the effective date of his resignation and retirement and the date of his first post-retirement purchases—Varnes sold 6,300 shares of Lilly stock. Three thousand of these shares had been acquired by him by the exercise of the 1970 option on March 26, 1971; the remaining 3,300 shares had been acquired by him by the exercise of the 1969 option on March 26, 1971. He realized net proceeds of \$781,631.29 from the sale of

Opinion

these shares. Varnes made no other sales of Lilly stock in 1971.

Plaintiff claims a "short-swing" profit of \$499,706.29 resulted therefrom—the difference between the price paid by Varnes for the shares purchased on February 2, 1971 under the 1967 option (\$281,925.00) and the price he received upon the sale of an equivalent number of shares. Although he attacks its validity herein, plaintiff recognizes that Rule 16b-6, if valid, would limit any recovery from Varnes to the sum of \$151,631.29.¹

The question presented herein by the facts recited above is in all respects identical to that which was before Judge Gurfein in *Levy v. Seaton*, 358 F. Supp. 1 (S.D. N.Y. 1973), an action in which plaintiff's counsel herein represented plaintiff Levy. Judge Gurfein stated the question thus: "Where *both* the purchase and the sale within six months of each other occur *after* the officer has left the employ of the corporation does a §16(b) liability arise?" Judge Gurfein, in a well reasoned opinion, answered the question in the negative, and that answer—clearly the correct one—is dispositive of plaintiff's claim herein.²

Accordingly, defendant is entitled to summary judgment dismissing the §16(b) claim.

¹Because of the disposition reached herein, it is unnecessary for this Court to pass upon the validity, *vel non*, of Rule 16b-6. However, the Court of Appeals has heretofore upheld that rule in *Kornfeld v. Eaton*, 327 F. 2d 263 (2d Cir. 1964).

²Apparently recognizing the novelty of the question presented—as does plaintiff herein, *see* Plaintiff's Memo in support, at 15—Judge Gurfein proceeded "on the assumption that there will be an appeal." 358 F. Supp. at 4. Accordingly, he entered judgment pursuant to Fed. R. Civ. P. 54(b) on March 15, 1973. No appeal was taken by the plaintiff in *Levy*.

*Opinion**The Section 10(b) Claim*

Plaintiff has also pleaded a claim for relief alleging a violation of §10(b) of the Act and Rule 10b-5 thereunder. A similar claim was likewise appended to the §16(b) claim pleaded in *Levy v. Seaton, supra*. There, Judge Gurfein characterized as "a bare allegation" language virtually identical to that contained in the instant complaint which, insofar as it attempts to state a claim under §10(b), is predicated on "information and belief" of an unspecified nature. Defendant argues cogently that an allegation that "defendant * * * possessed inside information with respect to the affairs of the Issuer which was not generally available to the investing public", and that he "unfairly used such inside information in effecting * * * transactions" such as those complained of herein, fails to state a claim upon which relief may be granted in favor of the corporation as against its former officer or director. This may well be so, but it is not a question this Court is required to decide at the present time.

A complaint alleging a §10(b) or Rule 10b-5 claim sounds essentially in fraud. As such, it is subject to the requirement of Fed. R. Civ. P. 9(b) that the circumstances constituting fraud shall be stated with particularity. The office of a fraud complaint is to seek redress for a wrong, not to find one. *Segal v. Gordon*, 467 F. 2d 602, 607-08 (2d Cir. 1972). Allegations of fraud have serious repercussions in the business world, and should not be cavalierly appended to other claims for their presumed *in terrorem* effect. *See* Fed. R. Civ. P. 11.

Here, there is no support whatsoever for the conclusory allegations of fraud pleaded. Accordingly, the complaint is defective on this point and will be dismissed for that reason.

Opinion

Summary judgment dismissing the §16(b) claim is granted to defendant. The §10(b) claim is dismissed for failure to comply with Fed. R. Civ. P. 9(b), with leave to replead within 20 days upon a proper factual showing or, if upon information and belief, upon a full and sufficient assertion of the basis therefor.

Complaint dismissed accordingly with costs.

So ORDERED.

January 4, 1974

MILTON POLLACK
U. S. District Judge

Judgment Appealed From.

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

HARRY LEWIS,

Plaintiff,

against

GEORGE L. VARNES and ELI LILLY AND COMPANY,

Defendants.

72 Civil 4897(MP).

Defendants having moved the Court for summary judgment dismissing the 10(b) and 16(b) claims and the said motion having come on to be heard before the Honorable Milton Pollack, United States District Judge, and the Court thereafter on January 4, 1974, having handed down its opinion granting the defendants summary judgment dismissing the 16(b) claim, and dismissing the 10(b) claim for failure to comply with Federal Rule of Civil Procedure 9(b), with leave to replead within 20 days upon a proper factual showing or, if upon information and belief, upon a full and sufficient assertion of the basis therefore. Complaint is dismissed accordingly with costs, it is,

ORDERED, ADJUDGED AND DECREED, that defendants, George L. Varnes, and Eli Lilly and Company, have summary judgment against the plaintiff, Harry Lewis, dismissing the complaint with costs to be taxed.

Dated: New York, N. Y.

January 7, 1974

RAYMOND F. BURGHARDT

Clerk



ATTORNEYS FOR *Deft.*
George L. Varnes